Supreme Court, U.S.
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No. 98-1176

IN THE

Supreme Court of the United States

MCI COMMUNICATIONS CORPORATION AND SUBSIDIARIES AND TELECOM*USA, INC. AND SUBSIDIARIES,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY FOR THE PETITIONERS

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REPLY FOR THE PETITIONERS

1. In their petition, petitioners demonstrated (1) that this Court's precedent provides little guidance to the lower federal courts on whether deference is owed to Revenue Rulings (Pet. 9-11); (2) that the decision below deepens a persistent split of authority among the lower federal courts (Pet. 11-18); and (3) that this important question of federal administrative and tax law merits this Court's review (Pet. 20-21). The government devotes most of its brief in opposition to arguing a position that the court of appeals rejected; namely, that the plain language of the "haircut" provisions of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2166, favors the government's position. (Opp. 2-15). When the government finally turns to the principal issue presented by the petition, it argues that this Court has already held that Revenue Rulings "are entitled to substantial deference" (Opp. 15-16) and that no conflict exists among the courts of appeals on this question (Opp. 17-19).

Petitioners show below, and showed in their petition, that the government is simply wrong. As evidenced by the *amicus* brief supporting petitioners filed by organizations representing thousands of corporations and business interests, there is an urgent need for uniformity on the issue of whether deference is owed to Revenue Rulings. Br. *Amici Curiae* of the Financial Executives Institute *et al.* at 6-7. Given that all courts of appeals but one have directly addressed this issue, there is little likelihood that the conflicting views of the lower federal courts will be resolved without this Court's intervention.[1]

2. Significantly, the government itself has recently petitioned for certiorari to resolve the identical issue in the context of Customs Rulings. Shortly after petitioners filed their petition, the government sought review of the Federal Circuit's decision in *Mead Corp. v. United States*, 185 F.3d

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[1] Only the First Circuit has not addressed the deference issue directly. *See Connor v. Commissioner*, 847 F.2d 985, 989 (1st Cir. 1988).

1304 (Fed. Cir. 1999), *pet. for cert. filed*, 68 U.S.L.W. 3566 (U.S. Feb. 29, 2000) (No. 99-1434). The Federal Circuit held in *Mead* that Customs Rulings, as well as Revenue Rulings, garner no deference because they "do not carry the force of law" and are not accompanied by the "procedural safeguards" of notice-and-comment rulemaking. Pet. 13, 17. In its *Mead* petition, the government described the deference issue as one of "substantial practical importance" because the Customs Service "has routinely employed rulings, rather than regulations, to address application of the detailed customs provisions to the 'limitless factual variations' created by modern commerce." *Mead* Pet. 22.

So it is with Revenue Rulings, which the *Mead* court specifically equated with Customs Rulings. *See* 185 F.3d at 1307. The Internal Revenue Service (IRS) has issued thousands of Revenue Rulings since 1953 and, over the past five years, has issued more than one Revenue Ruling per week. *See* M. Saltzman, *IRS Practice and Procedure* ¶ 3.03[2] n.12 (2d ed. 1991). These Rulings likewise address the "limitless factual variation created by modern commerce." Whether deference is owed these Rulings is also one of "substantial practical importance" meriting this Court's review.

3. The government fails to address petitioners' showing (Pet. 17-18) that Congress has not delegated to the IRS the authority to resolve statutory ambiguity via Revenue Rulings issued without public notice and comment. Instead, the government suggests (Opp. 15-16), relying upon *United States v. Correll*, 389 U.S. 299 (1967), that this Court has "long held" that "revenue rulings are entitled to substantial deference." The government likewise relies on *Correll* in its *Mead* petition to distinguish Customs and Revenue Rulings. *Mead* Pet. 16 n.6. Unfortunately, the government misdescribes *Correll*.

First, at the time of this Court's decision in *Correll* and of the events underlying that suit, the Treasury Department had

adopted a formal *Treasury Regulation* addressing the issue of whether expenses incurred on business trips not involving an overnight stay were deductible.[2] This fact was recognized both in the government's *Correll* petition and in the decision of the court of appeals. *See Correll v. United States*, 369 F.2d 87, 89 & n.2 (6th Cir. 1966), *rev'd* 389 U.S. 299 (1967); Pet. for Cert. at 6 n.3, *United States v. Correll*, 389 U.S. 299 (1967). Thus, the case did not present the question of deference to the Revenue Rulings that had preceded the Treasury Regulation.[3]

Second, and even more fundamentally, in *Correll* the government did not urge, and this Court did not decide, whether Treasury Regulations or Revenue Rulings standing alone were entitled to deference. Rather, the government urged, and this Court decided, that the reenactment of a tax statute, with Congressional knowledge and consideration of the Treasury Department's position (reflected in Revenue Rulings at the time of the reenactment), had the effect of incorporating the Treasury Department's interpretation into the statute. Thus, the government urged that "[i]t is well established that Congressional review and re-enactment of a tax statute after being informed of the Commissioner's

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[2] The Treasury Regulation provided that an employee "wish[ing] to secure a deduction" for business expenses "must submit a statement showing . . . [t]he nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him . . . broken down into such broad categories as transportation, meals and lodging *while away from home overnight*, entertainment expenses, and other business expenses." Treas. Reg. (under the 1954 Code) § 1.162-17(b)(3)(ii) (emphasis added); *see also id.* §§ 1.162-17(b)(4), (c)(2).

[3] Treasury Regulations, promulgated pursuant to the notice-and-comment process of the Administrative Procedures Act, are, of course, entitled to deference. *See* Pet. 16; *Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 389 (1998); *see also United States v. Haggar Apparel Co.*, 526 U.S. 380, 390-93 (1999) (deference afforded Customs Regulations).

interpretation provides persuasive evidence of tacit Congressional approval." Br. for the United States at 20, *United States v. Correll*, 389 U.S. 299 (1967). The Court agreed, holding that "Congress certainly recognized" the Commissioner's interpretation when it reenacted the relevant tax provision. *Correll*, 389 U.S. at 305 & n.20. *See generally* 1 K. Davis & R. Pierce, *Administrative Law Treatise* § 6.3, at 245-46 (3d ed. 1994). Similarly, in *Davis v. United States*, 495 U.S. 472 (1990), this Court's decision to give "considerable weight" to a Revenue Ruling turned on the fact that Congress had reenacted the relevant portion of the Code "using the same language, indicat[ing] its apparent satisfaction with the prevailing interpretation of the statute." *Id.* at 482; *see also* Pet. 9-10 & n.4. Absent this circumstance, the Court has "express[ed] no view as to whether [Revenue Rulings] are or are not entitled to deference." *Commissioner v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 162 n.3 (1993).

In this case, there has been no Congressional consideration of the IRS' position on the proper adjustment to basis for property subject to the investment tax credit haircut and no reenactment of the relevant statutory provisions. Indeed, the portions of the Code at issue here were repealed in 1990. *See* Pet. App. 11a n.12. This Court's precedent simply does not resolve the question whether deference is owed to Revenue Rulings standing alone. Indeed, the government simply omits from its opposition this Court's latest statement on the deference question: "The resolution of that issue is deferred to another day." *Keystone Consol. Indus.*, 508 U.S. at 162 n.3.

4. In addition to erroneously claiming that this issue is not open under this Court's decisions, the government wrongly asserts (Opp. 17-18) that the lower federal courts agree that Revenue Rulings are entitled to deference. They do not, and the split in authority has been acknowledged by the courts of appeals: "[T]his question has generated inconsistent rulings ranging from *Chevron* deference to no deference." *Bankers*

Life and Cas. Co. v. United States, 142 F.3d 973, 978 (7th Cir. 1998). Commentators also have pointed up the conflict: "The lack of consistency among the circuits results in inconsistent treatment of similarly situated taxpayers." L. Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 Ohio St. L.J. 1037, 1039-40 (1995).

The government admits in both its opposition (Opp. 18 n.10) and in its *Mead* petition (*Mead* Pet. 16 n.6) that the Federal Circuit has held that Customs Rulings, which that court expressly equated with Revenue Rulings, obtain no deference. The government asserts that this holding is "either incorrect or unclear." Opp. 18 n.10. The government also admits that the Eleventh Circuit, in *Estate of Kostow v. Commissioner*, 45 F.3d 1524 (11th Cir. 1995), ruled that Revenue Rulings are "merely an opinion of an IRS attorney," and characterizes the ruling as "incorrect." Opp. 18 n.9. But the government's view of the correctness of the Federal and Eleventh Circuits' decisions does not erase the split of authority.

The government also concedes (Opp. 17 n.8) that in *Mercantile Bank & Trust Co. v. United States*, 441 F.2d 364 (8th Cir. 1971), the Eighth Circuit held that Revenue Rulings "are of little aid in interpreting statutes." *Id.* at 368. Yet, the government attempts to explain this holding by noting that the court "considered" a Revenue Ruling. Opp. 17 n.8. But the mere fact that the Eighth Circuit did not ignore the Revenue Ruling does not equate to affording that Ruling deference; a court might uphold an agency position "because the agency persuades the court that the position taken . . . is the only correct way to interpret the language of the statute the agency is implementing." 1 Davis & Pierce, *supra*, § 6.3 at 243.

The government errs in describing (Opp. 17-18) the Tenth Circuit's precedent as "unambiguously" holding that deference is owed to Revenue Rulings. As petitioners have pointed out

(Pet. 9, 11), that court's precedent is at least ambiguous, though its most recent pronouncement indicated that Revenue Rulings garner only "consideration," and not deference. *American Stores Co. v. Commissioner*, 170 F.3d 1267, 1278 (10th Cir.), *cert. denied*, 120 S. Ct. 182 (1999).

Finally, the fact that the Tax Court will "follow a Court of Appeals decision which is squarely on point where appeal from [its] decision lies to that Court of Appeals and to that court alone" does not, as the government suggests, ameliorate the conflict. Opp. 19; *Golsen v. Commissioner*, 54 T.C. 742, 756-57 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir. 1971). The Tax Court "hears and decides significantly more tax cases having substantial legal and economic impact than the federal district courts or the United States Claims Court." M. Taylor *et al.*, *Tax Court Practice* 1 (8th ed. 1993). Given the "inconsistent rulings [in the courts of appeals] ranging from *Chevron* deference to no deference" (*Bankers Life*, 142 F.3d at 978), these numerous Tax Court decisions will reflect and exacerbate the split of authority. As a commentator recently observed, "It is especially disconcerting when, under *Golsen*, the Tax Court applies different rules to different taxpayers in the same case, or different rules to the same taxpayer in different years due to a change of residence [resulting from a move to a different circuit]." D. Shores, *Rethinking Deferential Review of Tax Court Decisions*, 53 Tax Law. 35, 40 (1999). Moreover, to the extent that the position of a court of appeals on the deference question is unclear, as the government suggests is the case in some circuits (Opp. 17-18), the Tax Court presumably will continue to apply its rule that no deference is owed to Revenue Rulings. Pet. 12.

5. The government errs in contending (Opp. 14) that the deference question was "ultimately immaterial" to the decision below. The government's attempt to downplay the role that deference played wholly ignores the explicit acknowledgment by the court of appeals that "[f]ortunately" it was "not left

wholly to [its] own devices" when "analyz[ing] the interplay of three quite technical statutory provisions." Pet. App. 7a. The court of appeals noted that there were no Treasury Regulations on point (Pet. App. 23a) and observed that Revenue Ruling 87-113, 1987-2 C.B. 3, reflected the IRS' position (Pet. App. 12a). It engaged in a lengthy discussion of the proper weight to be given Revenue Rulings (Pet. App. 7a-10a), ruled that it must afford "some deference to the IRS' revenue ruling" (Pet. App. 7a), and found that Revenue Ruling 87-113 contained a "reasonable construction of the words of the statutory provisions" (Pet. App. 13a). It concluded by "uphold[ing] the interpretation of the Tax Reform Act reflected in Revenue Ruling 87-113 . . . ." Pet. App. 25a. Thus, there can be no question but that the "interpretive guide" of deference (Pet. App. 7a) played an important role in the decision below.

The government likewise errs in claiming (Opp. 11) that the decision below can be affirmed on the ground that the "taxpayer bears the burden of establishing that Congress has clearly authorized the claimed deduction." A taxpayer bears the *evidentiary* burden of "establish[ing] the amount of a deduction claimed." *Helvering v. Taylor*, 293 U.S. 507, 514 (1935) (citing *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)). This burden of establishing the *facts* necessary to sustain a deduction does not place a special "burden" on the taxpayer to establish the proper meaning of the statute under which it claims the deduction. In *Lykes v. United States*, 343 U.S. 118 (1952), this Court noted that the aphoristic language of *New Colonial Ice* does not alter a court's duty to determine the "fair and natural meaning" of statutory language providing for a deduction. *Id.* at 120 & n.4 (citing E. Griswold, *An Argument Against the Doctrine that Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 Harv. L. Rev. 1142 (1943)). Neither the government nor the court below cited a single case in which

the *New Colonial Ice* "burden" was dispositive of a statutory interpretation question.

6. The government devotes the majority of its opposition to arguing that its position is correct on the merits because of the plain meaning of the statutory language. The court of appeals clearly did not rest its holding on this ground, acknowledging that "it would not be unreasonable to conclude that a credit is not 'determined' until it is used . . . ." Pet. App. 14a-15a. And, on the merits, the position of the government and the court below is wrong.

Former I.R.C. § 48(q) requires that basis be adjusted by the amount of the credit "determined under § 46(a)." In the government's view, a credit is "determined" under former § 46(a) when property is placed into service and the property's basis must be adjusted by this amount under § 48(q). The government contends that if a taxpayer is required to reduce the credit under the carryforward haircut requirement of former § 49(c), the taxpayer may not adjust the basis accordingly. The language of §§ 46, 48, and 49, however, avoids this inequitable result by permitting a basis adjustment that reflects the actual credit taken by the taxpayer. Petitioners and the government agree that the amount of the allowable credit is that "determined" under § 46(a) and that the "haircut" (§ 49(c)(2)) reduces the "determined" amount under that section. Pet. 18; Opp. 3-5. Since § 48(q)(1) provides that "the basis of such property shall be reduced by . . . the amount of the credit so determined," the amount of the basis reduction must equal the amount of the "determined" credit. The government, however, seeks to read the statute as though § 48(q) provided that "the basis of such property shall be reduced by . . . the [initial] amount of the credit so determined [before the haircut reduction]." That is not what the statute provides. Petitioners'

commonsense reading also is strongly supported by the legislative history of the Tax Reform Act of 1986.[4]

Congress in the Internal Revenue Code has consistently advanced a principle of full cost recovery over partial or "hypothetical" cost recovery. Both the court below and the government in its opposition (Pet. App. 21a; Opp. 9 n.3) misconstrue petitioners' argument in responding that the aggregate tax benefit of the credit and depreciation deduction equals or exceeds the benefit of full cost basis depreciation. The point is that, regardless of the amount of any investment credit, the Code has consistently required reduction of basis only (at most) by the amount of the credit actually allowed. The government has not offered, and neither the statutory language nor legislative history suggests, any reason why Congress would have departed from this principle in this instance. Petitioners merely seek to utilize their actual costs in depreciating property and no more.[5]

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[4] The Conference Report to the Tax Reform Act of 1986 specifically indicates that "[a] taxpayer is required to reduce the basis of property that qualifies for transition relief ('transition property') by the full amount of investment credits earned with respect to the transition property (after application of the phased-in 35-percent reduction, described below) . . . ." H.R. Conf. Rep. No. 99-841, at II-63 (1986), *reprinted in* 1986 U.S.C.C.A.N. 4075, 4151. It further indicates that "for transition property that is eligible for a 6.5 percent investment tax credit, the basis reduction would be with respect to the 6.5 percent credit, not the unreduced 10 percent credit." *Id.* at II-64. *See* Pet. 18-20.

[5] Petitioners previously showed (Pet. 20 n.7) that in *B.F. Goodrich Co. v. United States*, 94 F.3d 1545 (Fed. Cir. 1996), the taxpayer claimed that its "reasonable expectations" of the availability of credits in the near future entitled it to determine cost basis when property was put into service. The Federal Circuit rejected this argument, holding that "[t]he statute simply leaves no room for consideration of Goodrich's 'reasonable expectations,' and we are unaware of any authority or rule of statutory construction which would permit us to give effect to Goodrich's 'reasonable expectations,' in contravention of statutory language." *Id.* at 1549. This is not merely a

7. As petitioners' *amici* state, "[t]he importance of a uniform deference standard cannot be overstated." Br. *Amici Curiae* of the Financial Executives Institute *et al.* at 6. These *amici* comprise the Financial Executives Institute, the National Association of Manufacturers, the National Foreign Trade Council, the Tax Council, and the United States Council for International Business. In total, the *amici* represent tens of thousands of corporations and corporate financial officers, as well as thousands of other businesses and organizations. *Id.* at 1-2. They have joined petitioners in requesting that this Court remove the "needless uncertainty in taxpayers' ability to plan their business affairs" created by the present "lack of uniformity on the deference issue." *Id.* at 6.

CONCLUSION

For the foregoing reasons, as well as those stated in the petition, certiorari should be granted.

Respectfully submitted,

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"procedural difference" between *B.F. Goodrich* and this case (Opp. 12 n.5), but a different substantive ground of decision.